

Amend Revenue and Taxation Code Section 6452.1 of the Sales and Use Tax Law to (1) *require* California purchasers incurring a use tax liability that do not hold a permit or license with the BOE to report use tax on their income tax return if they failed to report the tax to the BOE, and (2) specify that payments of use tax on the return shall be applied first as use tax.

Source: Sales and Use Tax Department

Existing Law. Under existing law, Chapter 3 (commencing with Section 6201) of Part 1 of Division 2 of the Revenue and Taxation Code imposes a use tax on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer. The use tax is imposed on the purchaser, and unless that purchaser pays the use tax to a retailer registered to collect the California use tax, the purchaser is liable for the tax, unless the use of that property is specifically exempted or excluded from tax. The use tax is the same rate as the sales tax and is generally required to be remitted to the Board on or before the last day of the month following the quarterly period in which the purchase was made. Generally, a use tax liability occurs when a California consumer or business purchases tangible items for its own use from an out-of-state retailer that is not registered with the BOE to collect the California use tax. Generally, when a person is late in payment of his or her use tax obligations, the BOE imposes a 10 percent penalty, plus interest, currently at the rate of 6 percent (7 percent beginning January 1, 2012).

In an effort to increase the public's awareness of the use tax and to encourage voluntary compliance in reporting the use tax, legislation enacted in 2003 (SB 1009, Ch. 718), required the Franchise Tax Board (FTB) to revise the personal income tax and corporations tax returns to add a separate line for use tax reporting. While the use tax law was enacted in 1935, this was the first time a line to report use tax appeared on the state's income tax returns. This legislation allowed consumers to *elect* to report use tax on their income tax returns for purchases made on or after January 1, 2003 as an alternative to reporting the tax to the BOE (certain individual consumers, businesses, and retailers already required to be registered with the BOE, however, may not use this alternative).

To further simplify reporting of use tax on the income tax return, legislation enacted during the 2011 Legislative Session, (SB 86, Ch. 14), allows eligible purchasers to use a "look-up table" to calculate the use tax liability to report on the income tax return. The table may only be used to report non-business purchases of less than \$1,000. Use of the look-up table to calculate the use tax liability is optional. However, if the taxpayer properly uses the table, the BOE is precluded from assessing a liability against the taxpayer for additional use tax.

Under these provisions, the law specifies that any payments of use tax made with an FTB return are first applied to outstanding personal income or corporations tax, whichever is applicable, and including penalty and interest thereon, and then to the use tax.

This Proposal. This proposal would require every person that is not otherwise required to file a sales or use tax return with the BOE to report qualified use tax on the income tax return filed with FTB. The provisions of this proposal would not apply to any person

that is not otherwise required to file an income tax return with the FTB, such as charitable organizations. Due to the fiduciary responsibility a paid tax preparer or CPA has in accurately preparing a tax return, requiring the reporting of use tax on the income tax return will also require a paid tax preparer or certified public accountant to make an inquiry with their client as to whether or not that client has a use tax liability.

In addition, this proposal would require that payments received on the FTB returns would be first allocated to cover use tax liabilities reported on the income tax return, and then to FTB liabilities.

Background. Data obtained from FTB indicated that professionally-prepared returns accounted for about two-thirds of the returns filed with FTB, yet individual-prepared returns were about three times more likely to report use tax. And, we learned that many tax practitioners did not necessarily believe they had a fiduciary duty to their clients to inquire about their clients' use tax obligations when preparing their state income tax returns, since payment of use tax on the state income tax return was merely a voluntary option. In response, in 2007, 2008 and 2009, the BOE sponsored legislation to not only eliminate the sunset date of these provisions (which has since been eliminated), but to also require businesses and consumers who have failed to report use tax to the BOE on their taxable purchases for the preceding year to report the use tax on the income tax returns for the taxable year in which the liability for the qualified use tax was incurred. However, none of these attempts were successful. The first and third attempts (AB 969, 2007, Eng and AB 469, 2009, Eng), were vetoed by the Governor, and the second (AB 1957, 2008, Eng), failed passage in the Senate Revenue and Taxation Committee.

The provision in law that specifies that payments of use tax included with the FTB returns shall be applied first to FTB taxes, interest and penalty was included in the original legislation that allowed for reporting of use tax on the FTB returns. However, this order of payments has resulted in considerable confusion in situations where a taxpayer fails to remit the proper amount when filing his or her return with FTB.

On occasion, taxpayers make errors while preparing their income tax returns (or file late and incur penalty and interest charges), and as a result, have a shortage with the return filed with FTB. When a shortage occurs, the law requires FTB to apply the amount paid with the return first to amounts owed to FTB, notwithstanding the fact that a taxpayer may have designated an amount of use tax on the use tax line. The FTB notifies the BOE of the shortage of the use tax amount, and the BOE sends correspondence to the taxpayer to explain the issue. In these situations, the taxpayer usually also receives a billing from FTB, as generally, there is further outstanding liability arising from the return filed that is due FTB. As a result, the taxpayer can end up with two shortage notices - one from the BOE and one from the FTB. Taxpayers are frequently frustrated as to why they receive a tax bill from the BOE when they believed the use tax was already paid to the FTB.

Since the use tax liability is generally much lower than the income tax liability due, allocating the payments to the use tax first would make more sense, and also prevent the taxpayer from having to deal with two tax shortage notices or a tax shortage of a tax the taxpayer believes was already paid with the return.

Section 6452.1 of the Revenue and Taxation Code is amended to read as follows:

6452.1. (a) Notwithstanding Section 6451, every person that purchases tangible personal property, the storage, use, or other consumption of which is subject to qualified use tax, as defined in subdivision (d), that is otherwise required to report and remit that tax pursuant to this part, shall ~~may elect to~~ report and remit qualified use tax on an acceptable tax return.

~~(b) (1) A person that reports qualified use tax on an acceptable tax return is deemed to have made the election authorized by this section.~~

~~(1) (2) (A)~~ In the case of a married individual filing a separate California personal income tax return, an election may be made to report either one-half of the qualified use tax or the entire qualified use tax on his or her separate California personal income tax return.

~~(2) (B)~~ If an individual elects to report one-half of the qualified use tax, that election will not be binding with respect to the remaining one-half of the qualified use tax owed by that individual and that individual's spouse.

~~(c) An election to report qualified use tax on an acceptable tax return shall be irrevocable.~~ An acceptable tax return that contains use tax shall be considered a tax return for purposes of this part.

(d) For purposes of this section:

(1) "Acceptable tax return" means a timely filed original return that is filed pursuant to Article 1 (commencing with Section 18501), Article 2 (commencing with Section 18601), Section 18633, Section 18633.5 of Chapter 2 (commencing with Section 18501) of Part 10.2, or Article 3 (commencing with Section 23771) of Chapter 4 of Part 11.

(2) (A) Except as provided in subparagraph (B), "qualified use tax" means either of the following:

(i) For one or more single nonbusiness purchases of individual items of tangible personal property each with a sales price of less than one thousand dollars (\$1,000), either of the following:

(I) The use tax imposed under this part, Article XIII of the California Constitution, in conformity with the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)), or in accordance with the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)) that has not been paid to a retailer holding a seller's permit or certificate of registration-use tax.

(II) The estimated amount of use tax as calculated by the board. The board shall annually calculate the estimated amount of use tax due according to a person's adjusted gross income and by July 30 of each calendar year make available to Franchise Tax Board such amounts in the form of a use tax table as part of the accompanying instructions of the acceptable tax return.

(ii) For one or more single nonbusiness purchases of individual items of tangible personal property each with a sales price of one thousand dollars (\$1,000) or more, or for any tangible personal property purchased for use in a trade or business, the amount of use tax imposed under this part, Article XIII of

the California Constitution, the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)), or the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)) that has not been paid to a retailer holding a seller's permit or certificate of registration-use tax.

(B) "Qualified use tax" does not include:

(i) Use tax imposed on the storage, use, or other consumption of a mobilehome or a commercial coach that is required to be registered annually pursuant to the Health and Safety Code or use tax imposed on the storage, use, or other consumption of a vehicle subject to identification under Division 16.5 (commencing with Section 38000) of the Vehicle Code, or a vehicle that qualifies under the permanent trailer identification plate program pursuant to subdivision (a) of Section 5014.1 of the Vehicle Code.

(ii) Use tax imposed on the storage, use, or other consumption of a vehicle, vessel, or aircraft.

(iii) Use tax imposed on a lease of tangible personal property.

(iv) Use tax imposed on the storage, use, or other consumption of cigarettes, tobacco products, or cigarettes and tobacco products for which the purchaser is registered with the board as a cigarette consumer, a tobacco products consumer, or a cigarette and tobacco products consumer.

(e) ~~(1) If a person elects to report qualified use tax on an acceptable tax return,~~ that A person shall report and remit the qualified use tax by reporting the amount due based on all taxable purchases of tangible personal property made during the taxable year for which the acceptable tax return is required to be filed. A person that has made one or more single nonbusiness purchases of individual items of tangible personal property each with a sales price of less than one thousand dollars (\$1,000) may satisfy his or her tax liability for those purchases by using the use tax table shown in the accompanying instructions of the acceptable tax return.

(2) The qualified use tax shall be reported on and remitted with an acceptable tax return that is required to be filed for the taxable year in which the liability for the qualified use tax was incurred.

(f) (1) The penalties and interest imposed under this part, in conformity with the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)), or in accordance with the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)) shall apply to use tax reported as qualified use tax on an acceptable return.

(2) Any claims for refunds or credits of any use tax reported as qualified use tax on an acceptable tax return shall be made in accordance with Chapter 7 (commencing with Section 6901) of this part.

(3) Qualified use tax shall be considered to be timely reported and remitted for purposes of this part, in conformity with the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)), and in accordance with the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)), if the qualified use tax is timely reported on and remitted with an acceptable tax return in accordance with the provisions of this section.

(g) Notwithstanding a person's payment of qualified use tax on an acceptable tax return, the board is not precluded from making any determinations for understatements of qualified use tax against that person in accordance with this chapter. However, with respect to one or more single nonbusiness purchases of individual items of tangible personal property each with a sales price of less than one thousand dollars (\$1,000), the board shall be precluded from making any such determination against any person who uses the use tax table for purposes of satisfying his or her use tax liability when the person uses that table in accordance with the accompanying instructions.

(h) Any payments and credits shown on the return, together with any other credits associated with that person's account, of a person that is required ~~elects~~ to report qualified use tax on an acceptable tax return shall be applied in the following order:

(1) Qualified use tax reported on the acceptable tax return in accordance with this section.

~~(1)(2)~~ Taxes imposed under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001), including penalties and interest, if any, imposed under Part 10.2 (commencing with Section 18401).

~~(2) Qualified use tax reported on the acceptable tax return in accordance with this section.~~

(i) (1) This section does not apply to a person who is otherwise required to hold a seller's permit or to register with the State Board of Equalization pursuant to Part 1 (commencing with Section 6001) of this division.

(2) This section applies to purchases of tangible personal property made on or after January 1, 2010, in taxable years beginning on or after January 1, 2010.

(3) The amendments made by the act adding this paragraph shall apply to purchases of tangible personal property made on or after January 1, 2011, in taxable years beginning on or after January 1, 2011.